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TAGS: ECON EAID ETRD EG
SUBJECT: Subsidy bill squeezes national budget

Ref: Cairo 0282

¶1. On January 31 Egypt's People's Assembly (PA) approved a bill adding LE 4.7 billion ($840 million) to the FY 2007/2008 budget to cover the rising cost of subsidies on imported food commodities. High international prices are driving Egypt's 10% inflation rate, and high wheat prices in particular are forcing the GOE to increase the food subsidy allocation to keep bread prices stable. The new allocation raises the total food subsidy budget from LE 9.4 billion ($1.7 billion) currently to LE 14.1 billion ($2.5 billion), out of a total FY 2007/08 budget of LE 244 billion ($43.3 billion). Two additional bills, approved today by the Shoura Council and now on their way to the PA, would increase food subsidies by an additional LE 1.7 billion ($309 million) and fuel subsidies by LE 20 billion ($3.6 billion). Passage of the two bills would bring the total budget for food and fuel subsidies to LE 80.8 billion ($14.6 billion). Given rising international commodity prices, the increase in the subsidy bill is not unexpected. However, the increase is double the amount the IMF estimated in its November Article IV Report.

¶2. Subsidies, wages and interest payments already account for almost 89.5% of total government revenue for FY 2006/2007, according to Standard & Poor's. Food and fuel subsidies alone amount to 22% of total expenditures, equivalent to 7% of GDP. In an effort to reduce the cost of subsidies, the government has announced a phase-out of subsidies to energy-intensive industries and has contemplated further fuel subsidy reductions and removal of subsidies on fertilizers. Food subsidies are Egypt's "third rail," but a press story on February 13 reported, for the first time, an official plan to reduce the food subsidy bill by doubling the price of "baladi" bread, the main staple of the Egyptian diet, from 5 paisters ($.01) to 10 piasters ($.02) (reftel).

¶3. Comment: Doubling the price of baladi bread would be very unpopular and likely prompt sharp popular reaction. We doubt such an increase is planned for the near future, but the February 13 article may have been a trial balloon to gauge public reaction to a possible rise in bread prices. So far, reaction has been muted, though protests over high food prices continue to occur, mostly in Nile Delta towns (septel). Though the food subsidy is expensive, it is dwarfed by the cost of the energy subsidy, which continues to rise with high global energy prices. A cut in this subsidy alone would free significant resources and help the GOE meet its stated goal of reducing the deficit by 1% each year between now and 2011. The current 7.5% deficit is one of the highest among middle income countries like Egypt. The IMF and other financial advisors have argued that reducing the fuel subsidy (a regressive tax which largely benefits the wealthy) is the best way to make inroads on the budget deficit. Given public anger over rising prices and perceptions that economic reforms only benefit the elite, however, the GOE has limited room for maneuver.
JONES